

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 133 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE J.N.BHATT and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed
to see the judgements? Yes

2. To be referred to the Reporter or not? Yes @2.
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3. Whether Their Lordships wish to see the fair copy
of the judgement? No

4. Whether this case involves a substantial question
of law as to the interpretation of the Constitution
of India, 1950 of any Order made thereunder? No

5. Whether it is to be circulated to the Civil Judge?
No

COMMISSIONER OF INCOME-TAX

Versus

KRISHNADAS GOVINDAS

Appearance:

MR MIHIR JOSHI for MR MANISH R BHATT for Petitioner
MR DA MEHTA, R.K. PATEL & BD KARIA for MR KC PATEL
for Respondent

CORAM : MR.JUSTICE J.N.BHATT and
MR.JUSTICE A.R.DAVE

Date of decision: 05/02/99

ORAL JUDGEMENT (per A.R. Dave, J.)

At the instance of the revenue, the Income Tax Appellate Tribunal, Ahmedabad Bench 'B', has referred the following question of law arising from its order for the opinion of this Court:-

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that the assessee was entitled to deduction of interest money paid to the two firms in question by way of business expenditure?"

2. The relevant facts pertaining to the case are as under:-

3. The assessee is a member of the HUF of Harivallabh Mulchand. The HUF and the members of the HUF were in the business of money lending and hosiery at the relevant time. There was a partial partition of the properties of the HUF and as a result thereof, certain financial adjustments had to be made by the members of the HUF. The assessee, as a result of such financial adjustments and upon distribution of certain properties of the HUF, had to make payment to two firms which were run by the members of the HUF, namely, M/s Laxmi Vijay Hosiery Works and M/s Harivallabh Mulchand. As the assessee did not make payment of the amount payable by him to other members of the HUF or to the firms named hereinabove, his account was debited in the books of the said firms.

4. As the assessee was indebted to the said firms and his account was debited in the above named two firms, the assessee had to pay interest to the said firms. The assessee was also doing business of money lending and he had also received income from the business of money lending during the assessment years 1966-67 to 1971-72, which are the relevant assessment years. The assessee claimed deduction by way of business expenditure of the amount of interest which the assessee had paid to the above named two firms from the interest income which he had received from his business of money lending. The deduction claimed by the assessee was Rs. 28,334/- for

the A.Y. 1966-67 out of his total business income received for the said assessment year, which was Rs. 42,186/-. For different assessment years income earned by the assessee from his money lending business and the amount of interest paid by the assessee to the above named two firms were different. It was the claim of the assessee that the amount of interest paid by him to the said two firms should be treated as his business expenditure because, had the assessee not permitted the said two firms to debit his account, he would have been constrained to pay the amount payable by him to the said firms from his funds invested in his business of money lending and in that event his business income would have been reduced and therefore the interest paid by him to the said firms was his business expenditure.

5. The above claim of the assessee for all the assessment years was rejected by the Assessing Officer. Being aggrieved by the said orders of assessment, the assessee had preferred appeals before the Appellate Assistant Commissioner but the said appeals were also rejected.

6. Being aggrieved by the orders passed by the Appellate Assistant Commissioner, the assessee had filed appeals before the Tribunal for all the years in question. The Tribunal had allowed the appeals on the ground that the assessee was also doing money lending business and if the assessee had paid his dues by withdrawing funds from his money lending business to the firms which had debited the assessee's account, the assessee could not have earned more interest from his money lending business.

7. Thus, in short, the question before us is, whether the interest paid by the assessee to the said firms can be said to be an expenditure laid out wholly and exclusively for the purpose of the business.

8. Learned Advocate Shri Mihir Joshi appearing for the Revenue has vehemently submitted that, looking to the provisions of sec. 37 of the Income-tax Act, 1961 (hereinafter referred to as the Act), the Tribunal could not have allowed the amount of interest paid by the assessee to the two firms named hereinabove as a business expenditure for the simple reason that the assessee had not borrowed money from the said firms for the purpose of doing business. Alternatively, he has submitted that in any case the amount with which account of the assessee was debited in the firms referred to hereinabove was not used for any business. The assessee did not pay the

amount to other members of the HUF of Harivallabh Mulchand as per the understanding arrived at amongst the members of the HUF and therefore his account had to be debited in the books of accounts of the above-named two firms. For the purpose of claiming business expenditure, the expenditure which can be allowed should be wholly and exclusively for the purpose of the business and in the instant case, as the assessee had not paid the amount of interest for the purpose of his business. According to the learned advocate, the Tribunal had committed an error by taking a different view than the one taken by the AO. He has relied upon the judgments delivered in the cases of Gopaldas Dahyabhai Lavsi v. Commissioner of Income-tax, Gujarat, 108 ITR 531 and Bai Bhuriben Lallubhai v. CIT, Bombay North Cutch and Saurashtra, 29 ITR 543.

9. On the other hand, learned advocate Shri D.A. Mehta appearing for the assessee has submitted that the view taken by the Tribunal in the matter of allowing interest paid to the firms as business expenditure is just and proper. He has submitted that had the assessee paid his dues at the relevant time in pursuance of the partition deed, his funds invested in money lending business would have been reduced to that extent and in that event he would have earned less interest from his money lending business. He has submitted that instead of using funds from his business, he permitted the family firms to debit his account so that the assessee can keep his funds in his business of money lending intact. It has been submitted by him that the interest income from the money lending business would have been substantially reduced if the assessee had withdrawn the money invested in his money lending business for the purpose of paying off his debt to other members of the HUF. It has been also submitted by him that by retaining funds in business of money lending, the assessee had earned substantial interest and that interest income had been offered for taxation by the assessee. Thus, the assessee had not only augmented his income of interest by retaining his funds in his money lending business but had also offered his additional income, which he otherwise would not have earned, to the revenue by way of taxation. He has, thus, submitted that the amount of debit balances in the said firms was indirectly used in his business of money lending because had he not got his account debited and had he withdrawn funds from his business of money lending so as to pay to the members of his family in pursuance of the partition deed, his income would have been reduced and therefore the interest paid to the said firms should be allowed as business expenditure.

10. The learned advocate appearing for the assessee has also relied upon the judgment delivered in the case of Badal Ram Laxmi Narain v. CIT, 191 ITR 296. He has submitted that looking to the law laid down by the Hon'ble Supreme Court in the case of Badal Ram Laxmi Narain (supra), the view taken by the Tribunal in the case of the assessee is just and proper and therefore the amount of interest paid by the assessee to the said firms was rightly allowed as expenditure from the business income of the assessee.

11. Relevant portion of Section 37 of the Act reads as under:-

37. General.--(1) Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession".

12. We have carefully gone through the statement of case and other relevant orders. Upon perusal thereof, it is very clear that the assessee had to make payment to the firms referred to hereinabove because certain amount had to be paid by the assessee in pursuance of the partial partition of the HUF of Harivallabh Mulchand. The assessee had received certain assets in pursuance of the partial partition and as value of the said assets was more than what he was entitled to, the assessee had to make some payment to other members of the family so as to make final financial adjustments. Instead of paying the said amount in cash, the assessee preferred to delay the payment by getting his accounts debited in the said firms. By no stretch of imagination it can be said that the amount which was so debited was used by the assessee for his business purpose. If the amount which was debited was not used for the business purpose, the amount of interest paid thereon can never be treated as an expenditure laid out or expended wholly and exclusively for the purpose of the business of the assessee which can be allowed in computing the income chargeable under the head "Profits and gains of business or profession". The deduction which is allowed under the provisions of sec. 37 is an expenditure laid out or expended wholly and exclusively for the purposes of the business. In the

circumstances, so as to decide whether a particular expenditure is allowable under sec. 37 of the Act, one has to examine the nature of the expenditure. The expenditure which is incurred must be for the purpose of the business. There should be connection between the expenditure and the business. The connection may not be direct but there must be connection or nexus between the expenditure incurred and the business or the income earned from the business.

13. So as to ascertain whether the expenditure incurred can be treated as the business expenditure, it is not necessary to know the motive of the assessee. In the instant case, the motive of the assessee, as submitted by the learned advocate appearing for the assessee, was to keep the amount invested by the assessee in his money lending business intact. By not disturbing the capital of the assessee which was invested in money lending business, according to the learned counsel for the assessee, the assessee had augmented his interest income which was offered for taxation and therefore as per his submission the extent by which the assessee's account was debited, was the amount used for the purpose of the business and therefore the interest paid on the said amount was business expenditure. It might be an intention of the assessee to keep his capital invested in money lending business intact so as not to reduce his income from the business, but that consideration is absolutely irrelevant. If one agrees with the submission made by the learned advocate appearing for the assessee, one may have to say that any interest paid on money borrowed for the purpose of purchase of a residential house or for purchase of a car for personal use can also be treated as business expenditure if the person purchasing the building or the car is also doing some business where his money has been invested. Such a person can very well argue that had he not borrowed money for the purpose of purchase of his residential house or the car, he would have been constrained to withdraw his capital from the business and in that event his business income would have been reduced. We do not see any justification or logic in the submission which has been made by the learned advocate for the assessee because the immediate purpose of getting account of the assessee debited in the books of the said firms was to delay the payment which the assessee had to make in pursuance of the partial partition. The immediate purpose was definitely not business as suggested by the learned advocate for the assessee. At the relevant time it was obligatory on the part of the assessee to make the payment to the other members of the HUF in pursuance of

the partial partition and non-withdrawal of funds invested in the assessee's business of money lending or keeping his capital in his money lending business intact was merely incidental.

14. From the facts of the case it is also clear that account of the assessee was debited to meet his personal obligation and not the obligation of his business and therefore the expenditure incurred by the assessee by paying interest on the amount so debited in the accounts of the firms referred to hereinabove was not for the purpose of carrying on the business. Thus the expenditure was not incurred by the assessee in his capacity as a person carrying on business and therefore the expenditure incurred in the nature of interest, by no stretch of imagination, be regarded as business expenditure.

15. So as to enable an assessee to claim the deduction in respect of interest on borrowed capital, the assessee must establish that interest was paid on the money which was borrowed by the assessee for the purpose of his business. In the instant case, as stated hereinabove, the amount on which the interest was paid was not borrowed for the purpose of his business, but that was borrowed or his account was debited only to meet his personal obligation and not for the obligation of his business.

16. Upon perusal of the judgments referred to by the learned advocate appearing for the Department, it is very clear that if interest is paid on the amount not borrowed for the purpose of business, it cannot be allowed as business expenditure.

17. The learned advocate appearing for the assessee has relied upon the case of Badal Ram Laxmi Narain (supra). In our opinion, the ratio of the said judgment does not help the assessee for the reason that in the said case an HUF was carrying on a business. The family had no capital of its own and the family was doing business with the help of borrowed capital. Upon partial partition, the members formed themselves into a partnership and continued the same business. On the date of partition, there was a debit balance of Rs. 1,75,310/- in the capital account of the family which was transferred in equal proportion to the personal accounts of the partners of the firm who were members of the HUF. The newly formed firm took over the business assets and liabilities of the HUF. Interest was paid on the debit balance of the partners by the firm and the question was

whether the interest so paid was allowable as business expenditure. As per the facts of the said case, the newly formed firm had taken over the debit balance of Rs. 1,75,310/- in consideration of the sale of the goodwill by the HUF and therefore looking to the facts of the said case, the interest paid by the firm was treated as an allowable business expenditure. Facts of the case on hand are absolutely different. In the case which is before us, the assessee got his account debited so as to meet his personal obligations and not for the purpose of his business. In the circumstances, in our opinion, ratio of Badal Ram Laxmi Narain (supra) would not help the assessee.

18. In view of above-referred discussion, we are of the view that the interest money paid to the two firms in question cannot be treated as business expenditure and therefore we answer the question in negative, that is, against the assessee and in favour of the revenue. The reference is disposed of with no order as to costs.

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